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CHARLES ELMO

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1931.

Nos. [redacted] 8

NATIONAL SURETY COMPANY, *et al.*,
*Petitioners*
(Appellants Below),

*vs.*

VALERIA E. CORIELL,
*Respondent*
(Appellee Below),

MORRIS WHITE, INC.,
*Respondent*
(Appellee Below),

IRVING TRUST COMPANY, as Receiver of Morris White, Inc.,
*Respondent*
(Appellee Below),

MICHAEL HOLLANDER, *et al.*, Constituting a Committee of Creditors of Morris White, Inc.,
*Respondents*
(Appellees Below).

## PETITIONERS' REPLY BRIEF

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## PETITIONERS' REPLY BRIEF.

Since the two cases are so interwoven that it is impossible to treat of one without touching on the facts and points of law in the other, we thought it would be better to reply to respondents' statements and arguments in a

single brief, answering first the points which relate to the order making the receivership permanent (No. 726), then the points with reference to the order of the Circuit Court of Appeals on the reorganization plan (No. 727), and finally the point raised with reference to both cases.

## No. 726.

### I. Order Making Receivership Permanent.

A. Concerning Petitioners' Participation in the Case.

In this case respondents would make it appear that petitioners have submitted to and acquiesced in the rulings of the District Court and have, in fact, consented to the decree making the receivership permanent.

Respondents' development of the facts in this respect is somewhat misleading. The record is replete with objections on the part of petitioners to the Equity Court's exercise of jurisdiction in the instant case. From the very beginning petitioners maintained that since the defendant corporation was insolvent within the meaning of the Bankruptcy Act, the Equity Court should not exercise jurisdiction to administer the estate, but should leave the administration of such an estate to the Bankruptcy Court.

The first opportunity petitioners had to object to the receivership and to the so-called reorganization plan was on the return to the rule to show cause why the offer of Lily White should not be approved. That was on May 26, 1931. Petitioners objected to the adoption of the offer on the ground that there was no schedule of assets and liabilities (R., 82) or of the net worth of the corporation (R., 86); also on the ground that the facts disclosed a bankruptcy "which is nearly 100 per cent." (R., 86) and that the entire plan was merely for the benefit of the sole stockholder of the defendant corporation, to wit, Morris White, husband of Lily White (R., 85).

On the next day, May 27th, petitioners sought an opportunity to examine the defendant, "in view of the fact that this is a bankruptcy" (R., 96). But petitioners' counsel was at the same time engaged in an important criminal trial and asked for a short postponement (R., 97). Petitioners renewed their complaint that no adequate statement of assets and liabilities had been furnished (R., 156-7). The Court, after having intimated that it would give petitioners a chance to examine Morris White, the president of the defendant corporation, itself conducted the examination (R., 173), despite the objections of petitioners that they had no opportunity to examine (R., 180-1). Immediately after the examination, of which more will be said later, the Court announced that it would approve the reorganization plan, granting an exception to the dissenting creditors (R., 195).

On the next day, May 28th, counsel for petitioners filed an affidavit (R., 198-202) praying that the plan be rejected and disapproved and that the receivership be vacated. Nothing further transpired until June 3, 1931, when the Court rendered its decree making the receivership permanent (R., 209-218).

Respondents, however, would make it appear that petitioners cooperated in the receivership and the reorganization plan, that they consented to the decree making the receivership permanent, and then for the first time objected to that receivership.

1. *Petitioners Did Not Cooperate In The Receivership.*

Respondents go so far as to say (See p. 9 of their brief) that a representative of the National Surety Company "became a member *ex officio* of the Creditors' Committee (R., 110)." But page 110 of the record does not bear out that statement. Instead, we find that a representative of the National Surety Company requested not to be put on the committee, although "the Committee re-

quested him to come on, *ex officio.*" It would seem that there is a difference between being a member of the committee and refusing to be a member.

2. *There Was No Consent Decree.*

Respondents also state that the decree sought to be reviewed was entered on consent and was therefore not subject to review (Respondents' Brief, p. 7). We do not understand the meaning of this statement, in view of the fact that the record, as we have just shown, is replete with objections on the part of petitioners to the Equity Court's exercise of power in this case. In view of the state of the record, it is surprising that respondents should appear in *this* Court and maintain that the decree of the District Court was a consent decree not subject to review. We can only say that this statement falls in the same category with respondents' statement (p. 9 of their brief) that petitioners' representative was a member *ex officio* of the Creditors' Committee.

Petitioners rely on the statement in the decree of June 3, 1931 that there was no opposition to the making of the receivership permanent (R., 209). But that is in line with the District Court's statement that Lily White's offer was one to *purchase* the assets of Morris White, Inc. (R., 227 in case No. 727). Suffice it to say that the Circuit Court of Appeals did not take either of those statements seriously.

B. Defendant Corporation Insolvent Within The Meaning of the Bankruptcy Act.

The two facts necessary for petitioners' contention in this case are undisputed and are brought out by the findings of both the District Court and of the Circuit Court of Appeals. The findings are, and there is ample evidence to support them, that the defendant corporation was insolvent and that it was not in a position to pay its cred-

itors. A state of bankruptcy was admitted by counsel for the defendant (R., 70), the District Court saw that the defendant was insolvent (R., 74-5), it was apparent on the face of the financial statement, such as was available (R., 83-4), the defendant had no liquid assets with which to satisfy any part of the debts (R., 74, 143). The District Court said (R., 191, 192):

> "My view, stating it very shortly, is this:
> "That if the estimate of value which has been placed upon the assets of the defendant corporation is anywheres near correct, it means, if this concern goes into liquidation, that the general creditors will get little or nothing as a result, * * *
> "I agree that the proposed reorganization is more or less of an attempt by Mr. White to lift himself by his bootstraps, in that there is here no capital with which to finance the new concern, save such as he thinks may be received on his business record from others who are favorably disposed toward him. All of us know, unfortunately too well, the present condition of business."

In commenting on the financial condition of the defendant corporation, and after stating the various estimates of its assets and liabilities (R., 234) the Circuit Court of Appeals said (R., 238):

> "Assets of an insolvent commercial corporation have long been recognized as a trust fund for the payment of its creditors."

C. Insolvency Within the Meaning of the Bankruptcy Act Precluded Equity Receivership.

With both courts finding the defendant corporation insolvent within the meaning of the Bankruptcy Act, we maintain that the Equity Court should not have continued the receivership, should not have approved the reorganization plan and should not have made the receivership permanent.

1. *Equity Had No Jurisdiction.*

The petition for the appointment of a receiver was filed by a simple contract creditor, alleging that the defendant corporation was solvent, but financially embarrassed and not able to pay its debts; and that if all of the creditors should pursue their remedies against the defendant and levy upon its assets, there would not be enough with which to pay the debt owed to the plaintiff. These allegations were by way of showing that the Equity Court had jurisdiction in the case to appoint a receiver and conserve the assets for the benefit of the creditors, and that the plaintiff had no adequate remedy at law.

The receiver, however, could not be appointed upon application of the simple contract creditor without the consent of the defendant.

> *Hollins* v. *Brierfield Coal & Iron Co.*, 150 U. S. 371.

It could defeat the application either by denying that the plaintiff had no adequate remedy at law, or by denying that the defendant was solvent.

The denial of "no adequate remedy at law" would have required the plaintiff to exhaust her remedies at law by obtaining a judgment on her contract. If the execution were returned *nulla bona*, then the Equity Court would be in a position to proceed with the receivership, provided the defendant were solvent. If the defendant denied that it was solvent, then it would become apparent that the plaintiff's remedy was under the Bankruptcy Act.

For this reason it has been held that a receiver can not be appointed upon application of a simple contract creditor, unless there is consent on the part of the defendant corporation, which admits that there is no adequate remedy at law, and also that it is solvent.

In view of the recent decisions of the Supreme Court, with reference to equity jurisdiction, the following ques-

tion arises: If, upon the admission of the defendant that the plaintiff has no adequate remedy at law, the Equity Court appoints a temporary receiver, and then it appears that the defendant at the time of the application was insolvent within the meaning of the Bankruptcy Act, should the Equity Court continue the receivership?

The cases we refer to are *Stratton* v. *St. Louis Southwestern Railway Company* (No. 178 Oct. Term 1931, decided Feb. 15, 1932) and *Matthews* v. *Rodgers* (No. 84, decided on the same day).

The first of these presents the stronger case. There, the railroad company brought suit to enjoin the collection of a tax, stating that it had no adequate remedy at law. The Secretary of State of Illinois, being anxious to have the constitutionality of the tax settled, and not realizing that the plaintiff had an adequate remedy at law by paying the tax and suing to recover the same, admitted the allegation.

Both the District Court and the Circuit Court of Appeals in the first proceeding and then the statutory three judge District Court in the second proceeding accepted the admission of the allegation, which gave the Equity Court jurisdiction, and enjoined the collection of the tax.

After the case was argued in this Court four times, it was held that the plaintiff did have an adequate remedy at law. The decree was reversed, and the cause remanded with directions to dismiss the complaint for lack of jurisdiction. That case stands for the proposition that the jurisdictional requirement of a lack of an adequate remedy at law cannot be waived by the defendant, and that as soon as the equity court finds that there is an adequate remedy at law, it must cease entertaining jurisdiction in the case.

Does the same rule apply in these friendly equity receiverships where the plaintiff alleges and the defendant admits that the defendant is solvent, but in the course of the proceedings it appears that the defendant was at all times insolvent within the meaning of the Bankruptcy

Act? What should the Equity Court do? Should it dismiss the case and relegate the plaintiff to his remedy at law provided by the Bankruptcy Act, as was done by Judge Woolsey in the case of *Municipal Financial Corporation* v. *Bankus Corporation*, 45 F. (2) 902, or should the Equity Court continue to exercise jurisdiction in an equity receivership and usurp the functions of the Bankruptcy Court, as was done in the present case?

This court has long looked with disfavor on "friendly" receiverships, in which the jurisdiction of the Equity Courts is invoked for the purpose of hindering creditors and of enabling the defendant in receivership to escape its obligations. In the case of *Harkin* v. *Brundage*, 276 U .S. 36, this Court, in an opinion by Chief Justice Taft, said (p. 52):

> "We do not wish what we have said to be taken as a general approval of the appointment of a receiver under the prayer of a bill brought by a simple contract creditor simply because it is consented to at the time by a defendant corporation. The true rule in equity is that under usual circumstances a creditor's bill may not be brought except by a judgment creditor after a return of 'nulla bona' on execution. When a receiver has been thus irregularly appointed on such a bill without objection, and the administration has proceeded to such a point that it would be detrimental to all concerned to discharge the receiver, the receivership has been permitted to continue because not seasonably objected to (*Pusey & Jones Co.* v. *Hanssen*, 261 U. S. 491, 497, 500; *Re Metropolitan Ry. Receivership*, 208 U. S. 90, 109, 111; *United States* v. *Butterworth-Judson Corp.* 269 U. S. 504, 513)."

In the cases cited by the Court in *Harkin* v. *Brundage*, this Court did not order the termination of the friendly receiverships, because those receiverships had not been seasonably objected to, and after the receiverships continued for considerable time without objection, it would

have been detrimental to all concerned to discharge the receivers.

In this case the objection to the receivership was seasonably made (See pp. 2-3, supra). The receivership was continued by the equity court, despite the continuous objections on the part of the non-assenting creditors. Furthermore, there would be nothing lost by terminating the receivership, for the only changes which had taken place were in form, not in substance. (See the reorganization plan, p. 10, infra). Therefore, the present case does not fall within the class of cases in which the friendly receiverships were permitted to continue.

It will also be remembered that those cases were decided before the decision of this Court in *Stratton* v. *St. Louis Southwestern Railway Company;* that is to say, before this Court had put a stop to the practice of invoking the jurisdiction of equity courts in cases where equity courts had no jurisdiction. Those cases permitting the receiverships to continue were rendered at a time when there were also suits to enjoin the collection of taxes, and the jurisdiction of the equity courts was not disturbed, although the plaintiffs had an adequate remedy at law. The question presented here is one of the fundamental jurisdiction of the courts of equity as applied to what it generally termed as equity receiverships.

2. *Abuse of Discretion.*

If, however, the continuance of the equity receivership is still within the sound discretion of the court, despite the insolvency of the defendant, then we submit the district court abused its discretion. In this connection we again stress the salient facts concerning the offer of Lily White to "purchase" the property of Morris White, Inc.

Morris White, according to his own testimony, was the *alter ego* of Morris White, Inc. (R., 181). Mrs. White, in her offer to purchase, contributed no cash or any other assets, or any security (R., 82), and so far as it appears,

after having made the offer, vanished from the picture entirely. The common stock, that is, the voting stock of the new corporation to be organized under this offer, was to be held by Morris White himself (R., 235).

Stripped of all fiction and camouflage, the "purchase" approved by the District Court sitting as a *Court of Equity*, amounts to this: that Morris White, having debts aggregating $1,072,000, would first undertake to pay $158,000 owed in taxes, would pay the sum of $50,000 in administration expenses, and also an indeterminate fee for counsel for the friendly creditors, receiver and himself, and then would deal with his creditors by giving them unsecured, unindorsed, non-interest bearing notes for 20% of their claims, while the remainder, 80%, would be wiped out by an issue of preferred non-voting stock; the business, if any, would be carried on as heretofore, except that Morris White would be assured of $60,000 per year and nothing further would be said about the $2,000,000 he had diverted from the corporate funds.

Practically all of the assenting creditors either gained, else did not lose anything by this arrangement. The federal and state governments were to be paid outright; Vincent Astor, the landlord, was interested in keeping the premises occupied (R., 101-2); others had a different axe to grind (R., 152). It would seem that such an offer of "purchase" with a view of paying off creditors, would shock the conscience of any Chancellor. Instead of seeking an equitable distribution of the assets of the corporation among the creditors, it appears that a fraud* was sought to be perpetrated upon the court and upon the dissenting creditors. Yet the District Court approved the plan over the objections of those creditors, whose claims aggregated over $120,000 (R., 198-201).

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* It appears that after the case was remanded to the District Court, a new claim for $1,025,000 suddenly came to light. This probably explains why petitioners' repeated demands for a certified statement of the assets and liabilities were not complied with. We are filing with the Clerk a certified copy of the claim and of the rule to show cause issued by the District Court.

The function of an equity receivership is to preserve the assets of a solvent corporation, so that all the creditors, rather than some of them, might be paid. In granting a receivership, an equity court in effect prevents each of the creditors from exercising his legal rights and declares a moratorium for the purpose of conducting the business of defendant for the benefit of all the creditors. In granting such relief, the *probabilities* must be that the creditors will be paid in full. For if the probabilities are that the creditors will not be paid in full, then the equity court would usurp the functions granted by law to the bankruptcy courts.

This test for continuing the receivership fails in the present case. There was nothing in the record to point to any condition which would lead to the conclusion that the creditors would be paid within a reasonable time. When asked whether any cash at all could be paid to the creditors at this time, counsel for the defendant answered that that would be impossible (R., 143). The District Court did not arrive at the conclusion that the plan showed promise of success so far as creditors were concerned. On the contrary, the court treated the entire matter as a hopeless proposition (R., 192).

D. Receivership for the Benefit of the Debtor, Not the Creditors.

While an Equity Court may declare a moratorium for the purpose of safeguarding the interests of all creditors, it may not keep the defendant in receivership for its own benefit at the expense of the creditors. "There is not any right of sanctuary in an equity receivership in the Federal court", said Judge Woolsey in *Municipal Financial Corporation* v. *Bankus Corporation*, 45 F. (2) 902, 906. Yet, that is just what the entire reorganization plan amounts to. It is a plan to relieve Morris White of a great part of his indebtedness.

Much was said by the friendly creditors pointing out Morris White as a philanthropist and benefactor of humanity in order to influence the equity court to give White another chance, or, as one of the creditors put it, "to see that justice to Morris White is done" (R., 104). After dwelling at length on the fine qualities of Morris White, which we do not need to dispute because the entire matter was irrelevant, this same creditor said: "* * * if this man is given an opportunity to come back and put three or four thousand* people to work, not a cent will be lost to anyone; everyone will receive their money back" (R., 105). Another creditor frankly admitted that his interest in the case was not so much to save the $20,000 owed to him by Morris White, Inc., as it was to put Morris White back into business so that he, the creditor, might profit by selling metal parts to the new corporation (R., 152).

In short, in this receivership proceeding, the friends of Morris White sought to put him back into business without the burden of his obligations. That was the essence of the reorganization.

If the plan was not to benefit Morris White, what need was there for the organization of a new corporation, another name for Morris White? What need was there for the issuance of preferred stock? The court itself treated this plan as one to benefit Morris White, although it did not take seriously his claim of ability to rehabilitate himself. The court naively permitted such reorganization, because it knew of no "wrongdoing on the part of Mr. White in the management of his business, save and except the freedom that he exercised in taking assets (about $2,000,000!) of this corporation and devoting them to his other business ventures"—the stock market, real estate (R., 102) and a directorship in the Bank of United States (R., 176). The Court told him that he must not do that during the receivership (R., 192).

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* He must have meant four or five hundred. See R., 166.

Since the plan was not one for relief of creditors, but for relief of the stockholder of the defendant corporation, we submit that the district court abused its discretion in making the receivership permanent.

E. Petitioners Deprived of Minimum Rights Under Bankruptcy Act.

We have stated in our petition and brief that the making of the receivership permanent deprived petitioners of rights under the Bankruptcy Act. To this the respondents have answered (Resp. Brief, pp. 11-12) that the petitioners were not deprived of their right to file a petition in bankruptcy. We admit respondents' statement, but that is not our contention. If we have not made ourselves sufficiently clear, we beg leave to do so now.

Our argument is not that the filing of the receivership proceeding deprived the petitioners of their right to file a petition in bankruptcy, but that the administration of the estate in the Equity Court, together with the fictitious sale of the property of the defendant corporation to Lily White, operated to deprive petitioners of certain minimum rights which are contained in the Bankruptcy Act.

Had there been no consent to the receivership, it could not have taken place on petition of a simple contract creditor.

> *Hollins* v. *Brierfield Coal & Iron Co.*, 150 U. S. 371.

This was therefore a consent receivership, equivalent to an assignment of the assets for the benefit of creditors.

> *Price, Receiver* v. *United States*, 269 U. S. 492, 502;
>
> *United States* v. *Butterworth-Judson Co.*, 269 U. S. 504, 513-4.

This means that if the defendant was solvent, as was alleged in the petition for receivership, then the creditors were entitled to payment in full. If, on the other hand, the corporation was insolvent, then the assets of the corporation became a trust fund to be distributed among the creditors according to their rights and priorities under the Bankruptcy Act. But if the latter is the case, then the Bankruptcy Act provides many safeguards preventing the diminution of the portion recoverable by the creditors.

1. *Safeguards for the Benefit of Creditors.*

Among the safeguards provided by the Bankruptcy Act are: (1) Preferential payments are prohibited, (2) The charges on the administration of the bankrupt estate and for counsel fees are carefully supervised and are subject to objection on part of the creditors, (3) The bankrupt estate must be appraised by disinterested appraisers; the appraisals must be made available to creditors, (4) A bona fide sale of the property must be made prior to distribution, (5) If a "composition" is allowed, then the bankrupt must be examined at a meeting of creditors, and he must file a schedule of assets and liabilities, (6) Compositions must be accepted by a majority of creditors in number and amount, (7) Security must be furnished by the bankrupt for the discharge of obligations assumed in a composition, (8) No composition may be approved, if the bankrupt was guilty of acts of commission or omission which would be a bar to his discharge in bankruptcy, (9) In case of composition, non-assenting creditors must be paid in money at least a portion of their claims.

*2. Safeguards Absent In the Present Receivership.*

Of these advantages, or safeguards, petitioners are being deprived by the permanent receivership and by the transfer of the assets of the defendant corporation to a new corporation, under the guise of a sale:

(1) In the present case the District Court permitted, nay *directed*, a preferential payment to a judgment creditor (R. 65-6, 72-75), and immediately after the reorganization order was approved, but before the decree was rendered, the court approved the payment in full to a large number of small creditors (R. 194-5).

(2) The administration expenses during the first seven weeks of the receivership were estimated at $50,000 over and above an indeterminate amount to be paid to counsel for the Creditors' Committee (R., 149-50). In addition the estate would be subject to an annual charge of $60,000 in the form of a salary for White himself (R. 168).

(3) No inventory was ever given to the court, nor was a judicial appraisal made. The objecting creditors have demanded a certified statement of the assets and liabilities of the defendant corporation, but none was forthcoming (R. 180-4).

(4) Although the offer of Lily White was one of "purchase", there was really no purchase or sale involved. (See p. 10, supra.)

(5) There was no examination similar to that conducted under Sec. 21-A of the Bankruptcy Act. The District Court having been requested to grant petitioners an opportunity to examine Morris White under oath, intimated that it would appoint a Special Master to take testimony (R. 97). But then the court undertook to examine Morris White, without giving petitioners an opportunity for cross-examination. For all of the evi-

dence was in possession of the defendant and the receiver, and it was not made available to petitioners. The examination conducted by the Court (R. 173-179) was more in the nature of a friendly chat in which Mr. White informed the Court that his failure in business was not due to any mismanagement of the corporation (R. 176), but only to the fact that he "took" the corporation's money and lost it in other enterprises. (R. 176).

(6) Instead of holding Morris White liable to the creditors for the corporate fund diverted by him, which together with the other assets would have been sufficient to pay all of the debts of the corporation, Morris White was permitted to get away with a promise or fond hope that, within less than four or five months, he would give his 150 creditors and five bankers "a nice little dinner, and have a check to go in full right on the plate, on the 20% of notes." (R., 175). The time has passed, and the creditors saw neither the check nor the dinner. And many a dinner will be missed by creditors if the Equity Courts throughout the country will undertake to condone diversion of corporate funds at the expense of creditors.

(7) Throughout the proceedings, the Creditors' Committee claimed to represent the majority of creditors, both in number and amount. But though this claim was challenged (R. 101), no proof to that effect was submitted to or required by the Court.

(8) *In fine*, no security was offered to guarantee the payment of the claims; and no cash was offered to pay the creditors in whole or in part.

No doubt respondents are right in saying that bankruptcy supersedes receivership and that the jurisdiction of the Bankruptcy Court within its proper sphere is essentially exclusive. But unless the decree of the District Court making the receivership permanent is set aside, the creditors will find no assets of the bankrupt from

which they may expect payment of the bankrupt's liabilities. By the magic change in the corporate name, the defendant corporation becomes an empty shell with no assets to be reached by the creditors. The exercise of rights in bankruptcy, to be effective, must be predicated on the assumption that the Bankruptcy Court will undo all that the Equity Court has done. A Court of Equity should not put itself in such a position.

That is why we maintain that under the receivership in the present case, petitioners were deprived of certain minimum rights which they had under the Bankruptcy Act; that is a situation which is likely to result whenever an Equity Court undertakes to administer property of an insolvent corporation; and that is why it has been repeatedly held that when it appears that a defendant in a receivership proceeding is insolvent within the meaning of the Bankruptcy Act, the Equity Court should not proceed to administer a bankrupt estate under the guise of an equity receivership.

## No. 727.

### II. Order Relating to the Reorganization.

The order sought to be reviewed in this case is the one modifying the order of the District Court rendered June 15, 1931, approving an offer of Lily White, the wife of Morris White, to "purchase" the assets of Morris White, Inc.

A. There Was No Sale.

We do not agree with respondents that the fairness of the reorganization plan approved by the District Court is not before this Court. That would have been so, if petitioners were given an aliquot share of the proceeds of a public sale, or of a bona fide private sale, conceded to yield as much as could be realized at a public sale. Here, however, as the court below said (p. 263):

> "There was no public sale and therefore no competitive bidding. Apparently what took place below was that an offer was made by Mrs. White for all the assets. The creditors' rights thereto were wiped out. They were directed to take preferred stock and notes. By the acceptance of the offer, the new corporation obtained the assets of the old Morris White, Inc. No new money or assets were provided. *If the transaction be termed a sale*, it was not a public sale." (Italics supplied.)

That there was really no sale, public or private, has already been demonstrated (pp. 9-10, supra).

The Circuit Court of Appeals could not sustain such a departure from law and equity. It held that whatever may be the rights of assenting creditors to enter upon a joint business career with Morris White, the District Court was without authority so to dispose of the contractual rights of the objecting creditors. It therefore

reversed the order of the District Court and held that the objecting creditors were entitled to payment in cash.

The propositions of law, on which this judgment was based, are well recognized and are the very propositions of law on which petitioners rely in their claim that the Circuit Court of Appeals did not go far enough in reversing the decree of the District Court. The court below said (R. 258, 263, 264):

> "Assets of an insolvent commercial corporation have long been recognized as a trust fund for the payment to its creditors. It has likewise long been recognized that contract obligations may not be impaired by the courts. * * * Private property may not be taken in violation of contract obligations. * * * The assets of the corporation may not be used as a fund for the benefit of the debtor rather than a creditor. * * *
>
> "We are unable to find authority for the claim of the appellees that the court has power to compel a creditor of any kind to accept stocks or promises to pay in the future in full extinguishment of his claim, without being afforded the alternative of receiving his proportionate share of the proceeds of the conventional sale of the property in cash. * * *
>
> "Their rights must be protected. They are ordinarily entitled to a public sale with competitive bidding, the assets to be sold to the highest bidder."

B. Estimate Versus Actual Sale.

But the court did not order a sale of the property in order to protect those rights of the objecting creditors. It merely ordered that an estimate be made of the assets of the defendant corporation, and that the objecting creditors be paid an aliquot share of the estimate.

In ordering that the value of the corporation's assets be estimated, the court below relied on the case of *Geddes* v. *Anaconda Co.*, 254 U. S. 590. We submit that neither that case, nor the others mentioned in the opinion, sup-

port the ruling of the Circuit Court of Appeals. In that case the conflict was not between the interests of the stockholders and those of creditors, but a conflict among stockholders themselves. Yet, even there, this Court held that the reorganization could be effected by the exchange of the properties of the corporation for the stock of another corporation only because the stock received in exchange had a definite and ready market value.

Here the objectors to the reorganization plan are not stockholders, but creditors, whose interests are apt to be sacrificed in an effort to reestablish the sole stockholder in the business. It is a settled proposition of law that any reorganization which recognizes and preserves the interests of the stockholders at the expense of creditors is invalid.

*Northern Pacific Railway* v. *Boyd*, 228 U. S. 482.

And the plan adopted by the Circuit Court of Appeals did not give sufficient protection to the creditors, from being subordinated to the interests of the stockholder.

Looking into the assets of this corporation, including the debt of about $2,000,000 owed by Morris White to the defendant corporation, it is submitted that the order of the court below is too indefinite and is impossible of performance.

It is not humanly possible for a Special Master in April, 1932, to determine what would have been realized for the assets, if sold at public auction in April, 1931. It is impossible to reconstruct the situation as it existed a year ago. Furthermore, the record shows that no inventory had been taken at the time of the appointment of the receiver nor at the time of the so-called "sale" of the property to Lily White; and there is no way of telling now what persons would have bid at the public auction for the property in April, 1931, and what would have actuated their bids.

Assuming that the estimate is to be made of a highest bid, not as of April 1931, but as of the present time, the order is still too indefinite and uncertain to safeguard the rights of creditors. This is not like estimating the value of a life estate based upon mortality and probability tables, where, after a tremendous amount of actuarial research, the probable error is reduced to a minimum. It is also unlike an estimate of the value of a particular piece of property which also may be determined with some degree of certainty. Here the problem is to estimate the amount of *a highest bid at a public sale,* and it is a matter of common knowledge that the variations are very wide among highest bids on the same type of property.

Assuming that an estimate is to be made, not of a highest bid at a public sale, either as of April, 1931, or as of the present, but of the value of the property itself, what should be the basis for valuation? If the valuation is to proceed upon the allegation in the complaint and the admission in the answer that the corporation was solvent, then there is no need for an estimate. The value of the notes and of the preferred shares is then at least the full amount of the debt. If the estimate is to proceed on the assumption that the corporation is insolvent, then should the valuation proceed on the reproduction cost theory, on the value of the assets to Morris White himself, on the prudent investment theory, or on the book value of the assets of the corporation? Should each item of the assets be valued separately or should the business be valued as a whole? What consideration should be given to such intangible items as "good will", "going concern value", "trade names" and "choses in action"? What, for example, should be done about the preferences allowed by the District Court? At last, the additional question arises, if the aliquot interest is less than the amounts of the debt owed to each creditor, by what right will the stockholder retain an interest in the property?

These are but a few of the difficulties which present themselves in connection with the modification of the reorganization plan ordered by the Circuit Court of Appeals.

C. Petitioners Entitled to Cash Proceeds of Actual Sale.

For this reason, petitioners maintain that nothing short of a public sale would adequately determine their share in the assets of the corporation.

We have referred this Court to a number of authorities sustaining our contention. To this respondents answered that the authorities cited were not in point (Respondents' Brief, p. 9), without, however, disclosing their reason for saying so. An examination of those cases will disclose that the authorities cited are in point.

*In re Prudential Outfitting Company*, 250 Fed. 504, is a decision holding that a creditor cannot be compelled to accept an aliquot interest in the assets of a corporation under the guise of a sale. In that case there was a reorganization plan somewhat similar to the one involved here, and the court held that such plan could not be forced upon a dissenting creditor. An actual sale had to take place even in the event of a reorganization, and, the court added: "the dissenting creditors must be paid their own proportion of the bid, which is their inviolable right." (p. 507).

In the case of *J. B. & J. M. Cornell Company*, 186 Fed. 859, the same court refused to confirm a sale solely for the reason that the bid required non-assenting creditors to accept a percentage of their claims payable in the future—a much less drastic provision than the one in the present case.

To the same effect is *In Re Northampton Portland Cement Co.*, 185 Fed. 542, 543, where the court thought that the proposed plan offered the creditors their only

opportunity of obtaining any payment upon their claims. But the court said:

> "Assuming the plan to be judicious, the question remains: Has the District Court any authority to enforce it? The fact that it has been approved by a large majority of the creditors is not decisive."

And the court then set aside the reorganization plan.

We cited some cases for the purpose of showing that this rule applies not only to private corporations, but also to quasi-public corporations, like national banks,

> *In re Sales of Assets of First National Bank of Florence*, 6 F. (2) 905, 910,

railroads,

> *Kneeland* v. *American Loan Company*, 136 U. S. 89, 97,

and other public utilities,

> *Merchants Loan & Trust Co.* v. *Chicago Railways Co.*, 158 Fed., 923, 928-9,
> *Gay* v. *Hudson River Electric Power Co.*, 184 Fed. 689, 693-4.

Perhaps respondents mean that the cases were not in point, because in some of them the attempts to force an aliquot interest on the dissenting creditors were made in bankruptcy proceedings. If so, note that Judge Learned Hand, delivering the opinion in the *Prudential Outfitting Company* case, *supra*, said:

> "Bankruptcy does not change the character of the creditors' claims, which are measured by, and collectible in money."

The *ratio decidendi* was that such are the rights of creditors without bankruptcy, and that the bankruptcy did not affect those rights.

Respondents are not satisfied with stating that the authorities cited by petitioners do not support their contention. They state further (page 9) "*None can be cited.*"

We therefore respectfully refer this Honorable Court to the case of

> *B. Borchardt & Co.* v. *Yarnyal Naval Stores*, 206 Fed. 366,

for the proposition that, if an actual sale is not had, the only way of satisfying an objecting creditor is by paying him off in full.

D. The Question is New in This Court.

If all the above points are resolved in favor of the respondents, the question in this case reduces itself to this: Granting that dissenting creditors are entitled to their proportionate share of the assets of the defendant corporation, must the court order a sale, or may it cause an estimate to be made of the assets and allow to each creditor his aliquot part of the estimate? This question has never been decided by this Court.

The decree of the court below has been treated as a radical departure from the accepted rules concerning the rights of creditors in corporate reorganizations, in an article entitled:

> *White* v. *Coriell:* A Recent Development in the Law of Corporate Reorganizations, 45 Harv. L. Rev. 697.

It is an able discussion of the subject, though we do not agree with its author that such development is desirable, or that the estimates would give less difficulty than a judicial sale.

Another illuminating article on the same subject appears in the February, 1932, issue of the Pennsylvania Law Review and is entitled:

> Legislative Bases of Corporate Reorganizations, 80 Penn. Law Rev., 579.

This article also takes the position that such a departure from the accepted course of corporate reorganizations would be desirable, but it rightly maintains that equity courts have no power to make such departure without legislation authorizing it.

The author also takes the position that even if the courts had the power so to override the will of dissenting creditors, it would not be advisable to exercise such power without express legislative sanction.

As to the power of the equity courts to dispose of the rights of creditors on the basis of an estimate, rather than on the basis of an actual sale of the properties, the author of the latter article says:

> "In America, the right of the court so to act, in the absence of enabling legislation is evidenced only by the *Rock Island* cases. Thus it would seem that those decisions are at best questionable. It is greatly to be regretted that the Supreme Court was not given the opportunity to review them" (p. 584).

In the *Rock Island cases*, 284 Fed. 945 and 284 Fed. 955, involving a reorganization of a public utility, the unsecured creditors were allowed an aliquot part of the assets in stock which had a ready market value in cash.

This Court granted a writ of certiorari in the case, 261 U. S. 611, but afterwards the case was dismissed per stipulation of counsel, 262 U. S. 762.

## III. Nos. 726 and 727.

A. Petitioners Waived No Rights.

In the *preliminary statements* of both cases, respondents would make it appear that petitioners had waived all right to object to either of the orders sought to be reviewed, because they participated in hearings before the Special Master after the case was remanded by the Circuit Court of Appeals. Our answer is that there is nothing in the record in these cases concerning any hearings before a Special Master, and the respondents' statement that in the future a motion would be made to dismiss the petitions on the ground that petitioners had waived all right of review, is not properly before the Court at the present time.

Furthermore, the fact that the Circuit Court of Appeals did not stay its mandate does not deprive this Court of jurisdiction to issue a writ directing the Circuit Court of Appeals to certify the case, so long as the case has not become moot.

> *The Conqueror*, 166 U. S. 110, 113.
> *L. & N. R. R. Co.* v. *Behlmer*, 169 U. S. 644, 648.
> *Carr* v. *Zaja*, 283 U. S. 52.

The fact that the decision of the Circuit Court of Appeals is not "final", in the sense of the term used concerning the finality of judgments of state courts, likewise does not affect this Court's jurisdiction.

> *Simmons Co.* v. *Grier Bros.*, 258 U. S. 82;
> *Toledo Co.* v. *Computing Co.*, 261 U. S. 399, 418.

## Conclusion.

1. In so far as the Equity Court was permitted to continue jurisdiction despite the insolvency of the defendant, the decision of the court below is contrary to the general rule laid down by this Court in

   *Stratton* v. *St. Louis Southwestern Ry. Co.*, 284 U. S. ——.

2. If the continuance of the jurisdiction was within the discretion of the District Court, then that court abused its discretion, and the Circuit Court of Appeals in affirming the order making the receivership permanent, permitted such a departure from the accepted and usual course of judicial proceeding, as to call for an exercise of this Court's power of supervision.

3. In so far as the receivership was continued despite insolvency, the decision of the court below is in conflict with the *principle** announced by this Court in

   *Harkin* v. *Brundage*, 276 U. S. 36, 52;
   *United States* v. *Butterworth-Judson Co.*, 269 U. S. 504, 513;
   *Hollins* v. *Brierfield Coal & Iron Co.*, 150 U. S. 371;
   *Pusey & Jones Co.* v. *Hanssen*, 261 U. S. 491, 497, 500;
   *In re: Metropolitan Ry. Receivership*, 208 U. S. 90, 109, 111.

4. In so far as the receivership was continued for the benefit of Morris White and not for the benefit of the creditors, the decision of the court below is contrary to the principle laid down by this Court in

   *Northern Pac. Ry.* v. *Boyd*, 228 U. S. 482.

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* On the facts the cases are distinguishable.

5. In so far as the court below held that, in the absence of a bona fide sale, non-assenting creditors may be paid an aliquot part of the estimated assets of the corporation, it has decided an important question of law, which has never been, but should be, settled by this Court.

Respectfully submitted,

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Dated, April 25, 1932.